

CITIZENS LEAGUE
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STATEMENT ON CHANGING THE FISCAL DISPARITIES LAW

Summary

The Minnesota Legislature ought to reject a change in the metropolitan fiscal disparities law that ultimately could reduce the size of the metropolitan pool of valuations by one-quarter.

A bill supported by the Association of Metropolitan Municipalities (AMM) would reduce from 40 percent to 30 percent the amount of commercial-industrial tax base that is contributed by each city to the metropolitan pool.

A reduction in the size of the pool will increase commercial-industrial property taxes in metropolitan area cities whose tax rates already are highest and reduce commercial-industrial taxes in cities whose rates are the lowest.

The impact on commercial-industrial taxes probably is the most frequently overlooked aspect of the fiscal disparities law. It is independent of how the tax base is redistributed. It is solely a function of the size of the contribution.

AMM officials contend that the existing law might be vulnerable to repeal in a few years because it works too well; that is, the officials believe some cities must give up an extraordinarily large portion of their tax base and other cities gain too much. Reducing the size of the pool reduces the amounts that cities give or receive.

The law--which provides that every city in the metropolitan area contribute 40 percent of its net growth in commercial-industrial value to a regional pool of valuations and then share in that pool--is working well. The difference between the highest and lowest city in per capita commercial-industrial tax base is about four to one, among cities over 9,000 population. Without the law the ratio would be 20 to one.

But if the Legislature agrees with the AMM, it should look at possible changes the existing formula for redistributing tax base to cities. Such changes wouldn't widen tax rates on commercial-industrial property as would a reduction in the contribution rate.

Other changes advocated by the AMM are consistent with the Citizens League's position, including phasing out special exemptions and not allowing cities to escape making contributions by undervaluing property.

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This statement is divided in five sections:

- (1) The fiscal disparities law is working well.
- (2) The law has become part of the underlying structure of the **property tax in the metropolitan area**. It isn't just **another bargaining chip the Legislature's biennial state aid package**.

(3) Some modifications are needed that are fully consistent with the original intent of the law.

(4) But the contribution rate should not be reduced.

(5) If the Legislature believes differences between "winners" and "losers" are too great, it should re-examine how the metropolitan pool is distributed.

(1) The fiscal disparities law is working well. The difference in the highest and lowest city in per capita commercial-industrial tax base is about four to one, among cities over 9,000 population. Without the law the ratio would be 20 to one.

Localities with the most commercial-industrial growth are making the largest contributions. The localities with the least amount of growth per capita are receiving the most in return.

From the beginning its sponsors recognized the law's effects need to be analyzed over the long term. Some cities can be winners at first, then losers, and, later, winners again. Some cities can be losers at first, then winners, and, later, losers again.

Remarkably, the law has been largely unchanged in 17 years. The only really substantive change occurred when the Legislature in 1979 partially closed a loophole that had allowed some tax-increment districts to escape making a contribution to the regional fiscal disparities pool.

(2) The law has become part of the underlying structure of the property tax in the metropolitan area. It isn't just another bargaining chip the Legislature's biennial state aid package.

The rearrangement of the tax base that is produced by the fiscal disparities law has been accepted by the Legislature as the legal location of commercial-industrial tax base, irrespective of its physical location. The Legislature has consistently used the rearranged tax base in its many formulas for distributing state aids to local governments.

The law works automatically, year after year, without the political readjustments that the Legislature regularly makes in its formulas for distributing state aids to local governments.

The Legislature has recognized that it would be unnecessary, and probably counterproductive, to modify both the fiscal disparities law and the state aid laws every biennium.

The fiscal disparities law always has been intended to accomplish a rough redistribution of the tax base, not detailed fine tuning that is possible with a state aids formula.

The fiscal disparities law doesn't eliminate the enormous differences in commercial-industrial tax base among some 190 cities and townships, 49 school districts, and seven counties in the seven-county area. But it does reduce those differences, thereby making the job of redistribution of revenues through state aids somewhat easier.

(3) Some modifications are needed that are fully consistent with the original intent of the law.

The Legislature should modify in the law to improve its equity:

- * Phase out exemptions in tax-increment districts.
- * Phase out a special exemption granted to South St. Paul.
- * Phase out a special exemption for property at Minneapolis-St. Paul International Airport.
- * Don't allow cities to escape making contributions by undervaluing property.
- * Don't allow cities to share in the pool if they prohibit commercial-industrial development within their borders.
- * Remove special treatment given to cities with a high percentage of mobile homes in their borders.
- * Remove special treatment given to cities with unusually high levels of market value per capita.

Another possible change deserves special consideration: whether to require sharing the tax base that was present before 1971. Under existing law only growth since 1971 is subject to sharing.

The pre-1971 base was not shared for two reasons: (1) a possibility that a city could end up with less total tax base than before, thereby endangering the security of bonds it might have issued, and (2) it had no bearing on the fiscal impact of cities' future land use decisions; sharing future growth was all that was necessary.

Cities whose growth has been concentrated in the years since 1971 believe they must contribute an unfair amount relative to the cities who had a substantial amount of growth before 1971. About 90 percent of the pre-1971 value is concentrated in 10 cities, most of which already are major contributors to the regional pool.

The pre-1971 base is a constant figure, not even subject to change based on inflation. Consequently, as years go by it becomes an ever smaller portion of the total base.

It's not urgent that the pre-1971 base be shared, but we'd not oppose phasing in the base over several years.

(4) But the contribution rate should not be reduced.

One change that should not be adopted is a reduction in the contribution rate. Currently, the law provides that 40 percent of the net growth in commercial-industrial value in each city since 1971 must be contributed to the metropolitan pool of valuations. A comprehensive proposal by the Association of Metropolitan Municipalities includes a reduction in the rate to 30 percent.

Reducing the contribution rate would produce these negative results:

- (a). It would increase commercial-industrial property taxes in the cities that already have the highest tax rates. Under existing provisions of the fiscal disparities law differences in commercial-industrial property taxes among cities in the seven-county metropolitan area are narrowed automatically. This effect is

independent of how the tax base is redistributed. It is solely a function of the size of the contribution. It probably is the most frequently overlooked aspect of the fiscal disparities law.

In 1987 a uniform metropolitan mill rate was applied to about 29 percent, on the average, of the value of every parcel of commercial-industrial property throughout the metropolitan area. The local mill rate applied to the rest of the value. The metropolitan mill rate was 112.238 mills.

Without a change in law, in coming years a larger proportion of commercial-industrial property will bear the uniform, areawide mill rate, approaching but never quite reaching 40 percent. What this means is that commercial-industrial property taxes will become more alike throughout the metropolitan area.

The proportion will grow to about 34 percent by 1995, according to a computerized projection prepared by the city of Minneapolis. If, however, the contribution rate is reduced, as recommended by the Association of Metropolitan Municipalities, the proportion will drop to about 28 percent in 1995.

If the contribution rate is reduced, the portion of each parcel of commercial-industrial property that bears the area-wide mill rate would be reduced. Consequently, differences in commercial-industrial property taxes among cities in the metropolitan area would widen. Commercial-industrial property taxes would rise in cities with above-average mill rates, including Burnsville, Maplewood, Minneapolis, Minnetonka, Shakopee, and St. Paul. Commercial-industrial taxes would drop in cities with below-average mill rates, including Edina, Mendota Heights, Plymouth, and West St. Paul.

(b) It would reduce the size of the fiscal disparities pool. If the contribution rate is reduced to 30 percent, as recommended by the AMM, the metropolitan pool of valuations in 1995 would be about \$3.0 billion, or \$600 million less than if the rate stays at 40 percent, according to Minneapolis' projection. For 1988 the pool totals \$1.8 billion.

Persons who advocate a reduction in the contribution rate usually suggest that the drop be offset by including the pre-1971 tax base in the pool. In the long run, however, a drop in the contribution rate to 30 percent as recommended by the AMM will reduce the size of the pool considerably below what it would be if the rate stayed at 40 percent, even if the pre-1971 base is included.

(c) It would erode the integrity of tax-base sharing. The Legislature has kept the contribution at 40 percent since the law was passed. It is the most fundamental part of the law. If the Legislature drops the percentage, additional efforts undoubtedly would be made in later years to drop the contribution even further, thereby eroding the law's most important component.

Dropping the contribution rate would seriously damage the psychological impact of the law. It would signal to everyone that tax-base sharing isn't as important as it once was.

(5) If the Legislature believes differences between "winners" and "losers" are too great, it should re-examine how the metropolitan pool is distributed.

(a) It's not necessary to reduce the contribution rate to reduce differences between the winners and losers. The contribution rate can stay at 40 percent. Many possibilities exist for modifying the distribution from the pool, without the ruinous effect of changing the contribution rate.

The current formula for distribution is per capita weighted by each city's total property wealth. Cities that are below average in market value per capita receive a larger distribution than those that are above average.

Possibilities for change:

- * Reduce the impact of the market-value-per-capita factor.
- * Base distribution on population only.
- * Guarantee that every city would receive a distribution back from the pool that is not less than a certain fraction of its contribution. The biggest net contributors in 1995 are projected to receive back only one-tenth of what they contribute. Perhaps that fraction could be changed to one-eighth or some other fraction.

APPENDIX

A table below illustrates that changes in the distribution formula can reduce the spread between winners and losers without the accompanying negative drawbacks--outlined earlier--of a reduction in the contribution rate.

The table indicates that by 1995 under existing law Hennepin County could be making a net contribution of \$995 million annually to the other six counties in the metropolitan area.

Under the proposal of the AMM, with, among other changes, the contribution rate dropping to 30 percent, Hennepin County could reduce its contribution by \$247 million of assessed valuation. The other counties still would be net winners but to a lesser degree.

However, if the contribution rate is kept at 40 percent, and the only change is to a distribution formula based on population only, Hennepin County could reduce its contribution by \$306 million.

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PROJECTED IMPACT TO 1995
NET GAIN OR LOSS BY COUNTY IN COMMERCIAL-INDUSTRIAL VALUATION
UNDER THREE OPTIONS

(Using computerized projections developed by city of Minneapolis)
(in millions of dollars of commercial-industrial tax base)

	<u>Current Law</u>	<u>Change from current law</u>	
		<u>AMM Proposal</u>	<u>Population Option</u>
Anoka County	\$+260	\$-66	\$-100
Carver County	+75	-11	-22
Dakota County	+216	-49	-20
Hennepin County	-995	+247	+306
Ramsey County	+192	-64	-108
Scott County	+55	-10	-25
Washington County	+197	-47	-31